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FM AMCONSUL GUANGZHOU
TO RUEHC/SECSTATE WASHDC 6934
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RUEATRS/DEPT OF TREASURY WASHDC
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UNCLAS SECTION 01 OF 02 GUANGZHOU 000121

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E.O. 12958: N/A

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SUBJECT: Coping with Rising Costs in South China -- Foreign
Companies Describe Strategy to Staffdel

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REF: 07 Guangzhou 1298

1. (SBU) Summary: Companies in south China told visiting congressional staffer David Lloyd that they are taking different approaches to deal with rising production costs in the Pearl River Delta. Wal-Mart executives said that they are working to develop long-term relationships with suppliers that can benefit both parties. Foxconn, which expects wages in the area to rise 10-15 percent this year, is reducing employment at its giant Shenzhen campus as it expands elsewhere in China and in other markets. Silverlit Toy Manufactory is staying put in the Delta area and continuing to focus on its design and manufacture of high end toys, even as many competitors move to lower wage locations. The company cited, as a number of others have done as well, the lack of infrastructure to move product to market. End summary.

Wal-Mart Building Long-Term Relationships

2. (SBU) Wal-Mart Global Procurement Chief Operating Officer Emilio Cui explained to David Lloyd, legislative aide to Senator Debbie Stabenow, that although the cost of labor and other inputs has risen in the Pearl River Delta and elsewhere in China, Wal-Mart has sought to build long-term relationships with suppliers. He said that Wal-Mart is trying to avoid hopping from supplier to supplier to chase the lowest price. The firm believes a long-term relationship can be beneficial both to Wal-Mart and the supplier.

3. (SBU) This approach is also consistent with Wal-Mart's new program to strengthen supply chain security. As reported reftel, Wal-Mart implemented a new program on January 1 that requires all new vendors to be pre-certified across a range of criteria assessed by independent auditors. Cui described the program as "beyond C-TPAT," the U.S. Customs and Border Protection's Customs-Trade Partnership Against Terrorism, that assures Wal-Mart that vendors meet its standards on labor conditions, product quality and safety, and reliability as a supplier. Cui said the pilot program had been implemented in Indonesia, Italy and Guangdong and Fujian provinces in China. It will be applied globally starting in June.

Foxconn Expanding Elsewhere, Looking Beyond Costs

4. (SBU) Foxconn Vice President for Corporate Human Resources Jacob Chen told us his firm believes that labor costs will be up 10-15

percent this year due in part to the new Labor Contract Law that went into effect at the start of the year. Foxconn, a Taiwan-invested contract manufacturer of a vast array of consumer electronic goods and China's largest exporter, is reducing the size of the workforce at its massive Shenzhen campus due in part to rising labor costs. Chen noted that the number of employees at the campus had already fallen from about 400,000 to 300,000 and would fall further. Foxconn has recently established new manufacturing facilities in other parts of China and is expanding in Vietnam, but "slowly" according to Chen.

15. (SBU) Chen explained that Foxconn looks at a range of factors besides wages when considering where to expand production. The firm also considers the cost of materials and the tax structure. Chen pointed out that another important factor was the presence of a local market for Foxconn to serve. China is still by far the home of Foxconn's largest workforce with some 600,000 employees according to Chen, followed by the Czech Republic and United States.

Silverlit Staying Put as Competitors Move Out

16. (SBU) Marketing Director Eddie Wong of the Silverlit Toy Manufactory, a Hong Kong-invested toy manufacturer, commented that his firm had seen labor costs rise by 15-20 percent in the last year. He also noted that the price of many materials had gone up by as much as 20 percent. Safety concerns had further increased expenses, largely due to increased laboratory costs. However, he explained that working with retailers, the firm would ensure that not all of the costs would be passed to consumers. He predicted that U.S. prices for Silverlit's products would only increase by 3-5 percent.

17. (SBU) Wong said many companies in the Pearl River Delta have been

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scouting out locations in western and central China. Jiangxi is a particularly popular destination among Taiwan investors, who, Wong said, were moving there "in droves." He commented that Taiwan investors were more likely to move as a group and noted that many were also going to Vietnam.

18. (SBU) Nevertheless, Wong said that Silverlit would not be moving from its current location in the near future. He explained that while the firm could save money on unskilled labor in other regions, there was little infrastructure to support Silverlit's operations. He commented that other potential sites lacked engineers and suppliers of more sophisticated components such as motors and precision gears. Wong emphasized that Silverlit targets a higher price market than many of its competitors. It will continue to compete on quality and by designing and manufacturing new, innovative products.

19. (SBU) In addition, Wong told us that concerns about toy safety continue to help Silverlit by disadvantaging low-quality competitors. Although the wide-scale closures of factories that took place during the Chinese government's four-month product safety and quality campaign have largely ended, according to Wong, many toy manufacturers in south China find it difficult to meet higher standards. He explained that the strengthened regime of inspections implemented at the start of the campaign was still in place and some producers have found that they are no longer able to cut corners in order to save costs.

110. (U) Staffdel Lloyd did not have an opportunity to review this cable before transmission.

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